

S
352.44 Olness and
L72MLOA Associates
1994 Montana State
 Lottery financial
 statements, years
 ended June 30,
 1994 and 1993

Montana State
Lottery
Financial Statements
Years Ended June 30, 1994 and 1993

MONTANA STATE LOTTERY

FINANCIAL STATEMENTS

Years Ended June 30, 1994 and 1993

STATE DOCUMENTS COLLECTION

JUL 2 1997

MONTANA STATE LIBRARY,
1515 E. 6th AVE.
HELENA, MONTANA 59620



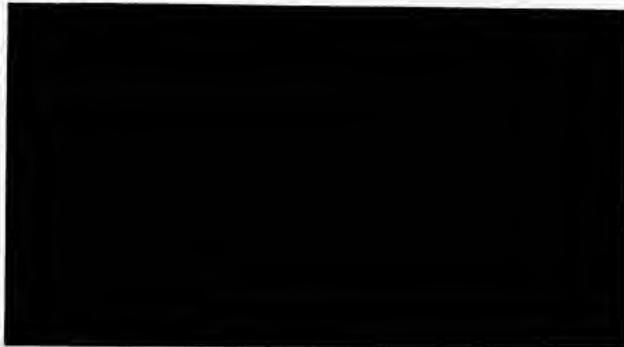
OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MONTANA
STATE CAPITOL • HELENA

MONTANA STATE LIBRARY



3 0864 0010 1649 5



MONTANA STATE LOTTERY

FINANCIAL STATEMENTS

Years Ended June 30, 1994 and 1993

TABLE OF CONTENTS

	Page No.
TRANSMITTAL LETTER FROM THE OFFICE OF THE LEGISLATIVE AUDITOR	1
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS	2
INTRODUCTION AND BACKGROUND	3
INDEPENDENT AUDITOR'S REPORT	4
FINANCIAL STATEMENTS	
Balance Sheets	5
Statements of Revenues, Expenses, and Changes in Retained Earnings	6
Statements of Cash Flows	7
Notes to Financial Statements	8
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u>	15
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <u>GOVERNMENT AUDITING STANDARDS</u>	17



STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL

PO BOX 201705

HELENA, MONTANA 59620-1705

406/444-3122

FAX 406/444-3036

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON

Operations and EDP Audit

JAMES GILLETT

Financial-Compliance Audit

JIM PELLEGRINI

Performance Audit

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

October 1994

The Legislative Audit Committee
of the Montana State Legislature:

Enclosed is the report on the audit of the Montana State Lottery for the year ended June 30, 1994.

The audit was conducted by Olness and Associates, PC, under a contract between the firm and our office. The comments contained in this report represent the views of the firm and not necessarily the Legislative Auditor. The report contains no recommendation, therefore, the agency did not provide a response.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Scott A. Seacat".
Scott A. Seacat
Legislative Auditor

MONTANA STATE LOTTERY
COMMISSION MEMBERS AND ADMINISTRATIVE OFFICIALS
JUNE 30, 1994

COMMISSION MEMBERS

Rebecca Erickson, Chairman

RESIDENCE

Glasgow

Cliff Brophy

Columbus

Larry O'Toole

Plentywood

David Kasten

Brockway

Dwaine Iverson

Shelby

ADMINISTRATIVE OFFICIALS

Charmaine Murphy, Director

L. John Onstad, Security

Gerald J. LaChere, Operations

Karalee Ellison, Marketing

MONTANA STATE LOTTERY

INTRODUCTION AND BACKGROUND

JUNE 30, 1994

INTRODUCTION

The purpose of our contract with the State and Montana State Lottery was to perform a financial-compliance audit of the Montana State Lottery's financial statements and issue an opinion on such. The scope of our services is defined in our contract with the Office of the Legislative Auditor, dated June 27, 1994, and as supplemented by certain requirements included in the bidder information.

As a result of our audit, we have issued an independent auditor's report on internal control structure and an independent auditor's report on compliance with laws and regulations, which include certain required comments per the contract.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the Montana Session Laws and Title 23, Chapter 7, of the Montana Code Annotated. The general purpose is to allow lottery games in which players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commission to sales agents and payment of operating expenses. The remaining revenue is transferred to the Montana Office of Public Instruction/School Equalization Account and the Montana Board of Crime Control.

Olness & Associates, PC

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying balance sheet of Montana State Lottery (Lottery), a component unit of the State of Montana, as of June 30, 1994, and the related statements of revenues, expenses and changes in retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Montana State Lottery as of June 30, 1993, were audited by other auditors whose report dated September 21, 1993, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery as of June 30, 1994, and the results of its operations, and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Olness & Associates, PC

September 2, 1994

MONTANA STATE LOTTERY
BALANCE SHEETS
June 30, 1994 and 1993

	<u>1994</u>	<u>1993</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 2)	\$ 3,023,658	\$ 3,078,823
Accounts receivable, less allowance for doubtful receivables of \$8,453 in 1994 and \$4,842 in 1993	872,264	1,703,655
Inventory	218,247	125,860
Other current assets (note 3)	<u>147,404</u>	<u>26,223</u>
TOTAL CURRENT ASSETS	<u>4,261,573</u>	<u>4,934,561</u>
FIXED ASSETS		
Furniture, fixtures, and equipment	1,569,363	1,566,281
Accumulated depreciation and amortization	<u>(1,403,559)</u>	<u>(1,361,318)</u>
	<u>165,804</u>	<u>204,963</u>
OTHER ASSETS		
Long-term receivable (note 4)	<u>1,131,198</u>	<u>589,144</u>
	<u>\$ 5,558,575</u>	<u>\$ 5,728,668</u>
LIABILITIES AND FUND EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 206,921	\$ 506,150
Estimated prize liability (note 5)	936,658	1,455,503
Transfer obligations (note 6)	2,656,575	2,787,138
Other current liabilities (note 7)	<u>456,279</u>	<u>269,173</u>
TOTAL CURRENT LIABILITIES	<u>4,256,433</u>	<u>5,017,964</u>
LONG-TERM LIABILITIES (note 8)	<u>1,300,782</u>	<u>709,344</u>
	<u>5,557,215</u>	<u>5,727,308</u>
FUND EQUITY		
Contributed capital	<u>1,360</u>	<u>1,360</u>
COMMITMENTS AND CONTINGENCIES (notes 9 and 12)	<u>-</u>	<u>-</u>
	<u>\$ 5,558,575</u>	<u>\$ 5,728,668</u>

See accompanying notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
Years Ended June 30, 1994 and 1993

	<u>1994</u>	<u>1993</u>
OPERATING REVENUES		
Instant ticket games	\$ 7,844,749	\$ 9,106,433
On-line games	29,638,035	27,656,397
License fees	2,500	5,650
TOTAL OPERATING REVENUES	<u>37,485,284</u>	<u>36,768,480</u>
COST OF TICKET REVENUES		
Instant ticket prize expense	4,296,652	4,944,962
On-line ticket prize expense	13,851,838	12,797,555
Retailer commission	2,068,256	2,058,730
On-line vendor fees	4,560,711	4,790,469
Cost of tickets sold	381,971	418,984
TOTAL COST OF TICKET REVENUES	<u>25,159,428</u>	<u>25,010,700</u>
NET OPERATING REVENUES	<u>12,325,856</u>	<u>11,757,780</u>
OPERATING EXPENSES		
Advertising	662,623	695,633
Bad debts	4,000	3,623
Communications	72,351	73,131
Contractual Services	537,064	406,248
Depreciation	42,241	115,606
Management fees	94,742	102,712
Multi-state operating fees	110,201	42,685
Personal services	1,155,612	1,186,383
Repairs and maintenance	82,358	82,020
Supplies and materials	162,591	112,447
Utilities and rent	92,623	93,745
Travel	36,383	35,820
Other	31,185	41,446
TOTAL OPERATING EXPENSES	<u>3,083,974</u>	<u>2,991,499</u>
OPERATING INCOME	<u>9,241,882</u>	<u>8,766,281</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	121,863	116,432
Loss on disposal of equipment	-	(595)
TOTAL NONOPERATING REVENUES (EXPENSES)	<u>121,863</u>	<u>115,837</u>
INCOME BEFORE OPERATING TRANSFERS	<u>9,363,745</u>	<u>8,882,118</u>
OPERATING TRANSFERS OUT		
Office of Public Instruction	(8,511,644)	(8,073,845)
Board of Crime Control	(852,101)	(808,273)
TOTAL OPERATING TRANSFERS	<u>(9,363,745)</u>	<u>(8,882,118)</u>
NET INCOME	-	-
RETAINED EARNINGS, BEGINNING OF YEAR	-	-
RETAINED EARNINGS, END OF YEAR	<u>\$ -</u>	<u>\$ -</u>

See accompanying notes to financial statements.

**MONTANA STATE LOTTERY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 1994 and 1993**

	<u>1994</u>	<u>1993</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income	\$ 9,241,882	\$ 8,766,281
Adjustment to reconcile operating income to net cash provided by operating activities		
Depreciation	42,241	115,606
Changes in operating assets and liabilities		
Accounts receivable	831,391	(1,042,495)
Inventory	(92,387)	14,811
Other current assets	(117,805)	(12,121)
Long term receivable	(542,054)	(17,321)
Accounts payable	(299,229)	88,321
Estimated prize liability	(518,845)	998,255
Other current liabilities	187,106	37,306
Long-term liabilities	<u>591,438</u>	<u>11,097</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>9,323,738</u>	<u>8,959,740</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers out:		
Office of Public Instruction	(8,630,325)	(6,777,694)
Board of Crime Control	<u>(863,983)</u>	<u>(574,763)</u>
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(9,494,308)</u>	<u>(7,352,457)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of fixed assets	(3,082)	(89,583)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(3,082)</u>	<u>(89,583)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest earned on investments	<u>118,487</u>	<u>113,965</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>118,487</u>	<u>113,965</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(55,165)	1,631,665
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>3,078,823</u>	<u>1,447,158</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 3,023,658</u>	<u>\$ 3,078,823</u>

See accompanying notes to financial statements.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 1994 and 1993

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Montana State Lottery (hereafter referred to as the Lottery) was created in November 1986 by a referendum vote of the people of Montana. Section 23-7-101, Montana Code Annotated (MCA) establishes the provision of the code under which the Lottery operates. The Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set ticket prices, determine the number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other states, and prepare financial reports. The Lottery is attached to the Montana Department of Commerce for administrative purposes.

Disposition of revenue is a minimum of 45 percent for prizes and a maximum of 10 percent for commissions to sales agents and payment of operating expenses. The remaining revenue is transferred to the Montana Office of Public of Instruction and the Montana Board of Crime Control.

Reporting Entity

The Lottery is includable as a component unit within the State of Montana financial statements. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Lottery's financial statements as a reporting agency.

Basis of Accounting

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations similar to private business enterprises where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retailers who market the tickets to the public on a commission basis. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by retailers may be returned for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets are made to licensed retailers who market the tickets through the use of computerized terminals on a commission basis. Revenue is recognized on drawing dates. Tickets sold in advance of future drawing dates are recorded as deferred revenue until the ticket becomes valid for a drawing.

Prizes

Prepaid prizes represent prizes purchased and on-hand in advance of game awards. Prize expense is recognized based on a predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Cash and Cash Equivalents

Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

securities. These funds are highly liquid and may be drawn on daily.

Inventory

Inventories consist of tickets and supplies. Ticket inventory includes instant lottery tickets that are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold. Unsold tickets are charged to cost of sales upon the end or cancellation of the related game.

Supply inventory is carried at cost and expensed as used.

Fixed Assets

Fixed assets are recorded at cost. Ordinary maintenance and repairs are charged to operations as incurred; major renewals and betterments are capitalized. Upon disposition or retirement of fixed assets, the cost and related accumulated depreciation or amortization is removed from the accounts. Gain or loss on disposal is reflected in operations. Depreciation and amortization are calculated on a straight-line basis over estimated useful lives of two to ten years.

Compensated Absences

State employees earn vacation leave ranging from fifteen to twenty-four days per year based on years of service. Vacation leave may be accumulated to a total not to exceed two times the maximum number of days earned annually. Sick leave accumulates at a rate of twelve days per year with no maximum accumulation. Upon retirement or termination, an employee is paid for 100 percent of unused vacation leave and 25 percent of unused sick leave.

Intangible Assets

Intangible assets represent the per ticket cost paid to Automated Wagering Inc. for advance on-line ticket sales. These ticket sales, also referred as deferred revenue, represent tickets sold prior to June 30, 1994 and 1993 for drawings held subsequent to year-end.

Reclassifications

The Lottery has reclassified certain prior year balances to conform to the current year's presentation.

NOTE 2 - CASII AND CASH EQUIVALENTS

Cash and cash equivalents consist of the following:

	<u>June 30,</u>	
	<u>1994</u>	<u>1993</u>
Short-term investment pool	\$ 2,881,100	\$ 2,730,600
Cash on deposit with State Treasurer	132,408	337,668
Cash in revolving deposit account	10,000	10,000
Cash in transit	-	405
Petty cash	150	150
	<u>\$ 3,023,658</u>	<u>\$ 3,078,823</u>

Reference to the audit of the State of Montana would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$10,258 at June 30, 1994 and was covered by federal

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

NOTE 3 - OTHER CURRENT ASSETS

Other current assets consist of the following:

	<u>June 30,</u>	
	<u>1994</u>	<u>1993</u>
Prepaid prizes and expenses	\$ 120,571	\$ 5,448
Intangible assets	12,072	8,390
Interest receivable on investment pool	10,761	7,385
Employee advances	4,000	5,000
	<u>\$ 147,404</u>	<u>\$ 26,223</u>

NOTE 4 - MULTI-STATE LOTTERY ASSOCIATION

Joint Venture Association

In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. The Lotto*America/Powerball game and the Tri-West Lotto game are presently the only games operated jointly by the members. Each lottery participating in MUSL is represented on the Board of Directors.

Prize Reserve Fund Receivable/Payable

As a member of the MUSL, the Lottery is required to contribute to various prize reserve funds maintained by MUSL. The contributions are to be used to fund unanticipated prize claims. All funds remitted, and the related interest earnings, will be returned to the Lottery upon leaving the association, less any portion of unanticipated prize claims, which may have been paid from the fund.

The Lottery contributes to the reserve fund through the set-aside for prizes. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

During 1990, the MUSL Board created the unreserved accounts to record interest earned on the various prize reserve funds when the prize reserve fund balance is not below the predetermined ceiling amount. The amounts in the unreserved accounts may be used at the Board's discretion.

The long-term receivable balance of \$1,131,198 and \$589,144 at June 30, 1994 and 1993, respectively, represents the Lottery's share of the MUSL prize reserve fund that had a balance of \$49,946,409 and \$26,281,598 for 1994 and 1993, respectively. The long-term liability balance of \$1,153,060 and \$571,823 at June 30, 1994 and 1993, respectively, represents the Lottery's share of the total estimated prize liability.

Lotto*America Prizes and Investments

Prizes awarded to Lotto*America grand prize winners are paid in twenty annual installments funded by investments in United States Treasury zero coupon bonds. Bonds purchased on behalf of Montana source winners are held in trust by MUSL with the Montana State Lottery as beneficiary. As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

At June 30, 1994 and 1993, MUSL held United States Government zero coupon bonds in trust for the Montana State Lottery winners with respective par values of \$51,060,111 and \$54,115,254 and respective market values of \$29,491,684 and \$30,837,895.

The Montana State Lottery has five Lotto*America winners. The combined total of future prize payments owed is \$51,059,000 and \$54,115,000 at June 30, 1994 and 1993, respectively. Total annual payments due over each of the next five years is \$3,053,000 annually and \$35,794,000 thereafter. The present value of future prize payments approximate the current market value of the bonds held in trust for the Montana State Lottery winners.

Multi-State Lottery Association Financial Position

Information related to the Multi-State Lottery Association's audited financial statements is as follows:

	June 30,	
	1994	1993
Total assets	<u>\$ 629,173,279</u>	<u>\$ 494,301,889</u>
Total liabilities	629,014,878	494,110,111
Total fund balance	<u>158,401</u>	<u>191,778</u>
Total liabilities and fund balance	<u>\$ 629,173,279</u>	<u>\$ 494,301,889</u>
Total revenues	\$ 2,191,190	\$ 1,625,280
Total expenses	<u>2,224,567</u>	<u>1,710,891</u>
Excess (deficit) revenues over expenses	<u>\$ (33,377)</u>	<u>\$ (85,611)</u>

NOTE 5 - ESTIMATED PRIZE LIABILITY

The estimated prize liability represents the Lottery's estimate of prizes payable related to games in process at year-end based on the predetermined prize structure of each outstanding game.

NOTE 6 - OBLIGATION TO TRANSFER FUNDS

Beginning July 1, 1992, the Lottery is required to transfer, each quarter, 9.1 percent of income before transfers to the Montana Board of Crime Control. The balance of income before transfers is transferred to the Montana Office of Public Instruction. The following is a summary of total transfer obligations outstanding:

	June 30,	
	1994	1993
Transfer obligation – Montana Board of Crime Control	\$ 241,748	\$ 253,630
Transfer obligation – Office of Public Instruction	<u>2,414,827</u>	<u>2,533,508</u>
Total transfer obligations	<u>\$ 2,656,575</u>	<u>\$ 2,787,138</u>

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

NOTE 7 - OTHER CURRENT LIABILITIES

Other current liabilities consist of the following:

	<u>June 30,</u>	
	<u>1994</u>	<u>1993</u>
Estimated return ticket liability	\$ 202,417	\$ 34,719
Due to other state agencies	172,930	185,107
Deferred on-line revenue	<u>80,932</u>	<u>49,347</u>
	<u><u>\$ 456,279</u></u>	<u><u>\$ 269,173</u></u>

NOTE 8 - LONG-TERM LIABILITIES

Long-term liabilities consist of the following:

	<u>June 30,</u>	
	<u>1994</u>	<u>1993</u>
Prize liability Multi-State Lottery Association	\$ 1,153,060	\$ 571,823
Accrued compensated absences	<u>147,722</u>	<u>137,521</u>
	<u><u>\$ 1,300,782</u></u>	<u><u>\$ 709,344</u></u>

NOTE 9 - LEASES

The Lottery leases its office, administrative and warehouse facilities under a lease agreement expiring February 1997.

The annual minimum lease payments under noncancelable operating leases, as of June 30, 1994, are:

Year ending June 30:	
1995	\$ 78,000
1996	78,000
1997	52,000

Rent expense under operating leases charged to operations was \$78,000 for the years ended June 30, 1994 and 1993.

NOTE 10 - EMPLOYEE BENEFIT PLANS

Pension Plan

All eligible employees of the Lottery participate in the Montana Public Employees Retirement System (PERS), a defined benefit, cost-sharing, multiple-employer retirement plan. The Lottery is required to contribute for full-time employees at the rate of 6.55% of annual compensation under State statute. Employees are required to contribute 6.55% of annual compensation. Part-time employees have an option to belong to the retirement plan, depending upon hours worked.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

The total number of Lottery employees covered during the years ended June 30, 1994 and 1993 was 34 and 42, respectively. Total payroll for Lottery employees was \$914,535 in 1994 and \$945,448 in 1993. Total covered payroll was \$880,321 and \$913,695 for 1994 and 1993, respectively. The Lottery's contributions were \$69,949 and \$59,847 for the years ended June 30, 1994 and 1993, respectively. Benefit eligibility is age 60 with at least five years service; age 65 regardless of service; or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least five years of service. Monthly retirement benefits are determined by taking 1/56 times the number of years of service times 60% maximum of final pay. Members' rights become vested after five years of service.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The Lottery is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total State basis, not agency basis.

The pension benefit obligation at June 30, 1993, (the latest information available) for the State system as a whole was \$1,405,884,112. The system's net assets available for benefits at cost on June 30, 1993 were \$1,107,748,782 leaving an overall unfunded pension benefit obligation of \$298,135,330. The Lottery's 1993 contribution represented less than 1% of total June 30, 1993 contributions required of all participating entities. The Lottery is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the State system's progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1993 annual financial report, which is available from the Montana Department of Administration.

Deferred Compensation Plan

The Lottery's permanent employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance. The amount of compensation deferred is not available to employees until termination, retirement, death, or unforeseen emergency. All amounts deferred under the plan created under Internal Revenue Code Section 457 remain the property of the State of Montana until paid, subject only to claims of the State of Montana's general creditors. Participants' rights under the plan are equal to those of general creditors of the State of Montana in an amount equal to the fair market value of the deferred account for each participant.

NOTE 11 - RELATED PARTY TRANSACTIONS

During the ordinary course of business, other State agencies provide certain services and supplies to the Lottery. During 1994 and 1993, total payments to other State agencies were approximately \$1,496,700 and \$1,440,000, respectively.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS (continued)
June 30, 1994 and 1993

NOTE 12 - COMMITMENTS AND CONTINGENCIES

Instant Tickets

The Lottery has signed agreements to purchase instant game tickets from Dittler Brothers, Inc., through June 1996. This contract may be canceled by the Lottery with proper notification.

Maintenance Contracts

The Lottery has signed an agreement for computer hardware and software maintenance with Stratus Computer, Inc., for \$5,334 per month. This contract expires February 1995.

On-Line Vendor

The Lottery has signed a contract with Automated Wagering International, Inc., a wholly owned corporation of Video Lottery Technologies, Inc., to provide on-line terminals, central computers, and a telecommunications network through November 1996. The contract provides for payments to be based on a percentage of weekly sales.

Prize Contingencies

Certain Big Spin prizes awarded are payable to the winners in annual installments spanning seventeen to twenty years with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance carrier under which purchased annuities will provide the required level of payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance carrier will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of the future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the gross amount of \$3,234,559 and \$3,484,559 at June 30, 1994 and 1993, respectively, if the insurance carrier defaulted on their payments.

Advertising

The Lottery signed a contract with Wendt Advertising to provide advertising services for \$12,750 through September 1994. The Lottery has the option to extend the contract for two additional years.

NOTE 13 - SUBSEQUENT EVENTS

Subsequent to fiscal year end 1994, the Governor's Task Force to Renew Montana Government approved a proposal submitted by the Lottery requesting permission to pursue public comment related to the Lottery's proposed privatization of operations. Lottery officials cannot anticipate the results of public comment or whether privatization will ultimately be approved.



Olness & Associates, PC

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), a component unit of the State of Montana, as of and for the year ended June 30, 1994, and have issued our report thereon dated, September 2, 1994.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Montana State Lottery for the year ended June 30, 1994, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of Montana State Lottery is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use of disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

•Cash	•Revenues and receivables
•Expenses for goods and services and accounts payable	•Payroll and related liabilities
•Inventories	•Fixed assets
	•Compliance with laws and regulations



INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS - continued

For all of the control categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the management of Montana State Lottery in a separate letter dated September 2, 1994.

This report is intended for the information of Montana State Lottery's Commissioners, management, and the legislative audit committee. However, this report is a matter of public record and its distribution is not limited.

Olmos + Associates, PC

September 2, 1994



Olness & Associates, PC

Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery (Lottery), a component unit of the State of Montana, as of and for the year ended June 30, 1994, and have issued our report thereon dated September 2, 1994.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations and contracts applicable to Montana State Lottery is the responsibility of the Lottery's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Montana State Lottery's compliance with certain provisions of laws, regulations and contracts. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that, with respect to the items tested, Montana State Lottery complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that Montana State Lottery had not complied, in all material respects, with those provisions.

However, we noted certain immaterial instances of noncompliance that we have reported to the management of Montana State Lottery in a separate letter dated September 2, 1994.

This report is intended for the information of Montana State Lottery's Commissioners, management, and the legislative audit committee. However, this report is a matter of public record and its distribution is not limited.

Olness & Associates, PC

September 2, 1994





